

Revised Final Plan Attachment 11.7

Response to Draft Decision: Incentive Arrangement

August 2017

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1. Response to Draft Decision on Incentive Arrangements

1.1 Introduction

This attachment sets out Australian Gas Networks Limited's (AGN's) response to the Australian Energy Regulator's (AER's) Draft Decision on the incentive arrangements to apply over the next (2018 to 2022) Access Arrangement (AA) period.

In our Final Plan we, along with AusNet Services (AusNet), proposed the introduction of a capital expenditure sharing scheme (CESS) with a network performance counterbalance (the Contingent CESS) to strengthen the incentives on AGN to incur prudent and efficient capital expenditure (capex). The Contingent CESS requires service performance of the network to be at or above historic levels in order to receive any potential CESS reward for improving capex efficiency. Any CESS penalties are passed through in full, irrespective of network performance.

Consistent with stakeholder feedback, the intent of the counterbalance is to ensure that any capex efficiency is not achieved to the detriment of service performance.

We also proposed the introduction of a Network Innovation Scheme (NIS), primarily to support initiatives to de-carbonise the gas network, as well as the continuation of the current operating expenditure (opex) incentive scheme (the Efficiency Benefit Sharing Scheme (EBSS)). Our Final Plan also determined the efficiency carry over amount arising from the EBSS that applied in the current (2013 to 2017) AA period, which amount will be recovered in the next AA period.

In its Draft Decision for the next AA period, the AER approved the continuation of the EBSS as well as the introduction of the Contingent CESS. The AER however did not approve the introduction of the NIS.¹

1.2 Stakeholder Engagement

For our Victorian and Albury AA review we undertook dedicated stakeholder engagement with the other two Victorian gas distributors (Multinet Gas and AusNet Services) on the incentives arrangement proposal contained within our Final Plan. Prior to submission of the Final Plan, the AER also released an Issues Paper in December 2016 discussing the merits of applying a CESS and a NIS to gas distributors.

Further to the feedback received during the stakeholder engagement process described above, in preparing this Revised Final Plan we have continued to engage with stakeholders, including our Reference Groups and through the submissions to the AER on our Final Plan. With respect to the latter, the AER also received seven stakeholder submissions that referred to the incentive arrangements proposed in our Final Plan (see Table 1.1).

¹ AER, *Attachment 14 – Other incentive schemes / Draft decision - AGN Victoria and Albury gas access arrangement 2018–22*, July 2017, page 14-5.

Table 1.1: Consideration of Stakeholder Feedback on our Incentive Arrangements

Stakeholder Feedback on the Final Plan	Our Response to Feedback on the Final Plan
<p>There was support for the continuation of the current EBSS to apply to opex in the next AA period.²</p>	<p>We have accepted the AER's Draft Decision, which provides for the continuation of the EBSS for opex.</p>
<p>There was mixed support for the proposed Contingent CESS. Some stakeholders considered the introduction of the Contingent CESS would provide appropriate incentives to balance the most efficient mix of capex and opex.³</p> <p>CCP11 supported some aspects of the design of the Contingent CESS, in particular network performance counterbalance and the asymmetric design.⁴ This reflected earlier stakeholder feedback that customers should not pay more for higher levels of service and that distributors should not be rewarded for inefficient capex deferral that results in lower levels of service. CCP11 did express concerns as to the appropriateness of the specific network parameters and how they would be used to measure network performance.⁵</p> <p>One stakeholder did not support the introduction of the Contingent CESS, but did encourage us to continue dialogue with the AER on the issue.⁶</p>	<p>We have accepted the AER's Draft Decision, which provides for the introduction of the Contingent CESS. The Contingent CESS proposed by the AER in its Draft Decision differs from that in the Final Plan, reflecting an expanded number of parameters to be used to measure network performance, consistent with stakeholder feedback.</p>
<p>There was general support for the introduction of the NIS, although CCP11 did question whether the proposed NIS design was sufficiently mature to apply in the next AA period.⁷</p>	<p>We have accepted the AER' Draft Decision not to apply the NIS this period. We will however continue to engage with the AER and stakeholders on the merits and design of a NIS for subsequent period.</p>

Note: In this 'traffic light' table, green shading represents no change from the Final Plan, orange represents a modification of the position outlined in the Final Plan and red shading represents a change from the Final Plan.

1.3 AER Draft Decision

The AER's Draft Decision in respect of our incentive arrangement proposal is summarised in Table 1.2.

² Red Energy and Lumo Energy, *Re: Australian Gas Networks Access Arrangement*, March 2017, page 1.

³ ATCO Gas, *Submission to Victorian Gas Networks (Australian Gas Networks and AusNet Services) Access Arrangement 2018-22*, March 2017, page 2.

⁴ Consumer Challenge Panel, *Advice to the Australian Energy Regulator | Consumer Challenge Panel Sub-Panel 11 | Response to proposals from AGN, AusNet and Multinet for a revenue reset/access arrangement for the period 218 to 2022*, March 2017, page 66-68.

⁵ *Ibid*, page 66.

⁶ Red Energy and Lumo Energy, *Re: Australian Gas Networks Access Arrangement*, March 2017, page 1.

⁷ Consumer Challenge Panel, *Advice to the Australian Energy Regulator | Consumer Challenge Panel Sub-Panel 11 | Response to proposals from AGN, AusNet and Multinet for a revenue reset/access arrangement for the period 218 to 2022*, March 2017, page 67.

Table 1.2: Summary of AER's Draft Decision on Incentive Arrangements

	AER Draft Decision	AER Comment
EBSS	Accept	Accepted the continuation of the EBSS to be applied in the next AA period.
Contingent CESS	Modify	Approved the amended design of the Contingent CESS in consultation with AGN following the submission of our Final Plan, which amendments largely focused on expanding the number (and coverage) of network performance measures.
NIS	Not Accept	Not accepted the introduction of the NIS.

Note: In this 'traffic light' table, green shading represents the AER's acceptance of AGN's Final Plan, orange represents the AER's modification of AGN's Final Plan and red shading represents the AER's rejection of AGN's Final Plan.

The amendments the AER made to the Contingent CESS in its Draft Decision reflect the stakeholder submissions received in response to our Final Plan as well as ongoing discussions between the AER, AusNet and AGN. The focus of these discussions was on potential network parameters that could be used to measure network performance and the thresholds whereby any potential benefits are reduced.

The AER's Draft Decision was to increase the number of parameters to be used to measure network performance from three to five. The five measures are leaks on mains, services and meters as well as unplanned System Average Interruption Duration Index (SAIDI) and unplanned System Average Interruption Frequency Index (SAIFI). The intention was to cover a greater share of total capex.

The AER also amended the Contingent CESS such that any CESS reward will be reduced if network performance is not maintained at historic levels over the next AA period and removed altogether if actual network performance falls below 80% of the historic levels. Any CESS penalties are passed through in full, irrespective of actual network performance.

1.4 AGN Response to the Draft Decision

We have accepted the AER's Draft Decision in respect of the proposed incentive arrangements to apply to the next AA period (see Table 1.3).

Table 1.3: Summary of AGN's Response to the AER's Draft Decision on Incentive Arrangements

	AER Draft Decision	AGN Response	AGN Comment
EBSS	Accept	Accept	We have accepted the AER's Draft Decision to continue to apply the EBSS in the next AA period.
Contingent CESS	Modify	Accept	We have accepted the amended Contingent CESS proposed by the AER in the Draft Decision.
NIS	Not Accept	Accept	We accept the AER's Draft Decision however we will continue to engage with the AER and stakeholders in order to arrive at an appropriate design of the scheme to be applied in the subsequent AA period or to other networks.

Note: In this 'traffic light' table, green shading represents the acceptance, orange represents a modification and red shading represents a rejection.

1.5 Summary

We have accepted the AER's Draft Decision in respect of the proposed incentive arrangements to apply over the next AA period. This will see the continued application the EBSS and the introduction of the Contingent CESS. The combination of the EBSS and the Contingent CESS will provide AGN with the appropriate incentive to balance the most efficient mix of opex and capex over the next AA period.

The Contingent CESS is the culmination of the extensive consultation that has occurred between stakeholders, the AER and the gas distributors. We have found that the open and transparent engagement over the past two years has fostered a collaborative environment that, we consider, has resulted in an outcome that will better serve the long-term interests of our customers.

The detailed design of the Contingent CESS also reflects the views of stakeholders and the AER that a network performance counterbalance is required so that gas distributors are not rewarded for the inefficient deferral of capex. Further, the asymmetry of the Contingent CESS reflects customers' satisfaction with current levels of network performance, and that a further financial incentive to improve network performance is therefore not required.

While we accept the AER's Draft Decision to not accept the introduction of a network innovation scheme, we will continue to work with stakeholders and the AER to design a scheme capable of being accepted.